No. 15,310

IN THE

United States Court of Appeals

For the Ninth Circuit

SUNLAND INDUSTRIES, INC.,
a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Petition for Review of Decision of United States District Court for the Southern District of California, Northern Division.

APPELLANT'S PETITION FOR A REHEARING.

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To the Honorable Clifton Mathews, William Healy and Stanley N. Barnes, Judges of the United States Court of Appeals for the Ninth Circuit:

Petitioner, on the grounds following, petitions for rehearing of the Court's judgment affirming judgment of the District Court.

1. THE COURT ERRED IN AFFIRMING JUDGMENT UPON THE BASIS THAT THE COMMISSIONER HAD THE POWER TO WAIVE THE REQUIREMENTS OF THE REGULATIONS BECAUSE THE REGULATIONS WERE MERELY A RESTATEMENT OF THE STATUTE. THE HOLDING OF THE COURT IS THUS THAT THE COMMISSIONER HAD THE POWER TO OVERRIDE AND DISREGARD A CONGRESSIONAL MANDATE, AND SUCH HOLDING VIOLATES ART. I, §1 OF THE U.S. CONSTITUTION AND CAUSES SERIOUS DOUBT TO BE CAST UPON THE VALIDITY OF THE EXCESS PROFITS TAX LAW.

As the Court will recall, the section of the statute involved in this case is § 710(a)(5)[1] of the excess profits tax law. This section was a special relief provision, applicable to only a relatively few corporate[2] taxpayers, and providing that under certain circumstances those who qualified under it could defer payment of a portion (only) of their excess profits tax. The statute clearly stated what a taxpayer was required to do in order to take advantage of this special privilege: (1) *it must* claim relief *on its regular return,* (2) the claim on the return *must* be made *in accordance* with the Commissioner's regulations. In view of the fact that a taxpayer who fulfilled the requirements of the section was allowed to defer a portion of its tax, § 710(a)(5) contained its own 'built in' statute of limitations. This special statute of limitations applied *only* to amounts of tax which remained unpaid *"Pursuant to . . ."* (the section) (Emphasis added).

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[1]The excess profits tax referred to was a tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939. (Slip Opinion, page 1.) §710(a)(5) [26 U.S.C. §710(a)(5)] is quoted Slip Opinion, pages 2 and 3.

[2]The excess profits tax applied to corporations only.

There is no question but that the Commissioner had to know, and did in fact know, that Petitioner deferred $65,000[3] of its tax; that taxpayer had failed to make a valid claim on its return; and that taxpayer had not even approximated compliance with the regulations (and, *a fortiori,* the statute[4]). The Commissioner acknowledges that he knew, but claims that he intentionally 'waived' petitioner's noncompliance with the law. The Government concedes that the issue we must eventually come down to is whether the Commissioner had the authority to do this[5] (Gov't brief, 10). Petitioner submits that the holding of this Court that he did have such power, directly or indirectly, violates Art. I, § 1 of the U.S. Constitution which provides in part that, "All legislative powers herein granted shall be vested in a Congress. . . ." See also, *Hawke v. Comm'r,* 190 F. (2d) 946 (C.A. 9th, 1940). The Commissioner apparently concedes, as he must, that he does not have the power to disregard a Congressional statute (Gov't brief, 11); and at the same time, concedes that he did.

Petitioner submits that § 710(a)(5) itself, and for good reason, clearly supports its position that the Commissioner not only did not, but was specifically foreclosed from, exercising such power; that Congress

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[3]For convenience all figures have been rounded off to the nearest $5,000.

[4]The case was submitted on briefs, the facts were all stipulated and are in the record. The record hereinafter abbrebiated "R".

[5]This is because if the Commissioner did not have such power the tax was not deferred pursuant to §710(a)(5) and was thus subject to the regular statute of limitations [26 U.S.C. 275(a) and 26 U.S.C. 276(b)] which had expired.

not only did not intend to give him such power, by implication or otherwise, but on the contrary took *particular care* to make certain that such power could not be implied.

As is obvious from the section, Congress left the details of the *form* of the information etc. which the taxpayer must submit to the discretion of the Commissioner, and it specifically authorized the issuance of regulations for this purpose. But in the same section the Congress nevertheless saw fit to *clearly spell out* the fact that the necessary information to substantiate a taxpayer's claim must be made *in accordance* with the regulations and *must be made on the regular return.* This requirement was clearly not left to the discretion of the Commissioner. It is petitioner's contention that the part of the regulation[6] which stated that if sufficient and satisfactory information was not submitted with taxpayer's return then the taxpayer automatically forfeited his right to any deferment and the entire tax became immediately due and payable, *was nothing more* than a restatement of the requirements of the statute.

Petitioner submits that the reasons why Congress was so deliberate was that any other course would have subjected the excess profits tax law to vulnerability of attack on DUE PROCESS grounds[7] because:

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[6]§35.710-5 of Regulations 112; quoted in opening brief for appellant, appendix iv.

[7]The words DUE PROCESS are intended to refer to the DUE PROCESS CLAUSE of the Fifth Amendment to the U.S. Constitution.

(1) The general rule that applied to the majority of taxpayers was that they had to pay their *entire tax* and the only remedy was to *subsequently* file for a refund (Sen. Finance Comm. rpt. on 1942 Bill).

(2) Because of the very nature of the law it was quite probable that many taxpayers would be entitled to refunds. The Code, however, limited the right to refund which might be found owing to taxpayer, and thus did not adequately compensate him for the loss of the use of his money. *Squire v. Puget Sound Pulp & Timber Co.,* 181 F. (2d) 745 (C.A. 9th, 1950).

(3) Since this could work a hardship and discriminate, particularly against taxpayers whose excess profits tax was an extremely high percentage of normal income, Congress provided in § 710 (a)(5) that if a taxpayer's excess profits tax was so high that it exceeded 50% of its normal tax net income, then taxpayer could defer a percentage[8] of its tax under certain rigid circumstances (Sen. Finance Comm. rpt. on 1942 Bill).

(4) The section thus discriminated in favor of a comparatively small group of taxpayers but such discrimination was reasonable because the amount of the deferment was carefully considered to allow the taxpayers in this special

[8]33% of the reduction in the tax to which taxpayer claimed he was entitled. Petitioner's return (R. 63) indicates that one of the errors it made was to multiply 33% by line 16 (the wrong line) to arrive at the figure of $63,768.68 (the amount improperly deferred).

category the privilege of retaining only enough of their tax as was deemed by Congress to be reasonable compensation for the potential hardship to which they might otherwise be subjected. *Squire v. Puget Sound Pulp & Timber Co., supra.*

(5) If Congress had allowed these special category taxpayers to defer more than a 'reasonable' amount of tax, while at the same time requiring the majority of taxpayers to pay immediately and seek refund later, then it seems probable that the excess profits tax law would have been vulnerable to attack on DUE PROCESS grounds.

(6) Congress therefore carefully spelled out the special circumstances under which a taxpayer was entitled to claim the benefits of the section. Whether a taxpayer was so entitled had to be determined at the time it filed its return or else everyone would have been able to defer. And even though it was determined that a taxpayer was in the special category the AMOUNT which it was entitled to defer had to be immediately determinable in order to insure that the statute had been complied with. For if the statute could have been construed to allow these special category taxpayers to defer all of their tax, or any other arbitrary amount, or if it had not been surrounded with sufficient safeguards to insure that only the 'reasonable' statutory amount had in fact been deferred, then the statute would have been vulnerable to attack, as suggested above.

A cursory glance at the Commissioner's regulations,[9] with particular attention to their tenor, would seem to indicate that the Commissioner fully understood all of the aforementioned implications; that he understood that there was a Constitutional limit to the amount of tax which a special category taxpayer could be allowed to defer; and that he understood that a 'reasonable amount' had been defined by Congress.

Petitioner submits that amounts not deferred pursuant to the statute, as in the case at bar, were subject solely to the regular statute of limitations. Not only is the language of § 710(a)(5) perfectly clear in this respect, but any other interpretation could only mean that the section somehow permitted a taxpayer to defer more than a reasonable amount and was thus arbitrary. Petitioner submits that Congress would not have had the power to so legislate even if it had attempted as much.

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2. THE COURT ERRED IN HOLDING THAT THE COMMISMISSIONER HAD THE POWER TO TREAT THE INFORMATION FILED TWO YEARS LATER AS THOUGH IT HAD BEEN SUBMITTED WITH THE ORIGINAL RETURN.

For the reasons stated above, Petitioner does not believe that Congress itself, in the premises, would have had the power to allow a taxpayer to defer

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[9] §35.710-5 of Regulations 112.

$65,000 and then wait two years before receiving information from the taxpayer which would substantiate the deferment; and this is particularly true where the belated information would only have authorized a maximum deferment of $15,000. At the time the 'corrected return' finally reached the hands of the Commissioner the regular statute of limitations still had one year to run, and the 'corrected return' showed the following information:[10]

Amount allowed to be deferred by statute	$15,000
Amount deferred by taxpayer	$65,000
Difference	$40,000

Conceding that the Commissioner had the power to treat the information filed two years later as if it had been attached to the original return, this Court, by holding that the Commissioner could set aside the statute of limitations as to this $40,000, squarely held that the Commissioner, directly or indirectly, had the power to disregard the Congressional mandate.

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3. THE COURT ERRED IN HOLDING THAT PETITIONER HAD NO RIGHT . . . TO PROFIT BY ITS NONCOMPLIANCE.

Petitioner is not certain whether this statement by the Court was intended as a basis for the holding,

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[10]The original return is at page 63(R). The Form 991 filed in 1946 is at page 78(R).

but for purposes of this petition it will assume that it was.

Petitioner interprets the Court's statement to mean that as the result of its mistake of law,[11] and because it derived a benefit from that mistake, taxpayer now is estopped to argue that the statute of limitations expired and it must consequently give up to the Commissioner any benefit which it might have derived as a result of that noncompliance.

In *Van Antwerp v. United States,* 92 F. (2d) 871 (C.A. 9th, 1937), the Commissioner used a similar argument of estoppel and this Court dismissed it. The Court said in part, "Fourteen months remained for such reaudit and deficiency assessment, during which the government did nothing. Having failed to do so, it seeks to transfer the loss from that neglect to appellant taxpayer." This Court in *Van Antwerp* carefully spelled out what would have been necessary to estop the taxpayer, and these elements are not present in the case at bar.

If what the Court intended to suggest was that petitioner is estopped because of inconsistency, petitioner submits that its position is, simply: (1) that it improperly withheld too much tax, (2) that the Commissioner was fully aware of this fact, (3) that

[11]"The federal excess profits tax law . . . is the most complicated revenue act in the United States history . . . it is safe to say that some of the statutory provisions . . . are so abstruse and confusing as to be hardly intelligible even to the experienced tax specialist . . ." 42 Colum. L.R. 1082 (1942).

the statute of limitations ran and (3) that the Commissioner may not now set that statute aside. If, as a matter of law, the statute of limitations did run, petitioner does not understand why it would either be estopped, or why it would be being inconsistent, to so argue. Regardless of this, however, this Court held in *Hawke v. Comm'r,* 190 F. (2d) 946 (C.A. 9th, 1940), that an inconsistent interpretation of the law by a taxpayer would not preclude him from invoking the statute of limitations. *See also, Comm'r v. Mellon,* 184 F. (2d) 157 (C.A. 3, 1950) (citing the *Hawke* case for this proposition).

Petitioner submits that the holding in the instant case squarely overrules the previous decisions of this Court in *Van Antwerp* and *Hawke;* the result being that the Commissioner is empowered to do indirectly that which the Constitution forbids his doing directly.

In addition, if as the Court held, the information filed two years after the fact corrected the original error, *nunc pro tunc,* or otherwise, then it must necessarily follow that petitioner at all times fully complied with the law, and its position that the Government is not entitled to set aside the statute of limiations at least as to the $40,000 could not be more straightforwardly consistent.

Petitioner is unaware of any case which has held that the basic and time honored statute of limitations could not be relied upon by a taxpayer where to allow him to do so might result in his benefiting by his own inadvertent noncompliance with the law. Petitioner submits that this can only mean that the statute of

limitations is no longer available to a taxpayer; the natural consequence of which would be to place a heavy premium in the future upon nondisclosure.

Petitioner does not believe that its position should be any different than it would be if instead it had forced the Commissioner to sue it. Petitioner submits that 'noncompliance' with the law in the case at bar was not unilateral, and that the one guilty of the most egregious noncompliance was not taxpayer. Petitioner has never believed, and does not now believe, that the question of equities is properly in issue. However, in order to help obviate the possibility of any misunderstanding in this respect, petitioner would like to assert that at all times it acted in the utmost good faith and that at all times it intended to, and attempted to, fully comply with the law. The Commissioner at all times was in complete possession of the facts and was in a far better position to know the law than was taxpayer. Petitioner fully cooperated with the Commissioner; it made full disclosure at all times; it attempted in good faith to correct its original error; and it believes that the record (although no attempt was made to introduce evidence for this purpose) demonstrates that everything was done which a conscientious citizen could have been expected to do under the circumstances. The petitioner has attempted to preclude the Commissioner from casting aside the statute of limitations because it believes, as was stated in *Van Antwerp,* that the law does not permit the Commissioner to now attempt to shift the loss resulting from his own neglect.

Petitioner very respectfully requests that this Court give favorable consideration to this petition for rehearing.

Dated, Fresno, California,
November 14, 1957.

Respectfully submitted,
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Certificate

The foregoing petition for rehearing is believed to be well-founded and is presented in good faith and not for delay.

Dated, Fresno, California,
November 14, 1957.

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